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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

Washington, DC 20554

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In the Matter of	)	
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Allocation of Costs Associated With Local Exchange Carrier Provision of Video Programming Services	)	CC Docket No. 96-112

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To: The Commission

COMMENTS OF TIME WARNER CABLE

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SUMMARY OF TIME WARNER CABLE'S COMMENTS

Time Warner Cable ("TWC") generally supports the proposals and tentative conclusions set forth in the Notice including, particularly, the adoption of cost allocation rules based on fixed allocation factors. TWC believes that pertinent public policy considerations and available data support a fixed allocation of 25 percent of common costs of jointly used facilities (including loops, interoffice trunks, switching plant, network related expenses, marketing expenses, and overheads) to the regulated services, with 75 percent being allocated to nonregulated services. None of the costs of excess broadband capacity that would not be needed to provide voice telephone services should be allocated to regulated services.

As TWC also pointed out in the OVS rulemaking, allocation rules need to be in place before certification of OVS systems can begin. Certification as to compliance with such rules should be an integral part of an OVS application.

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COMMENTS OF TIME WARNER CABLE

Time Warner Cable ("TWC"), a division of Time Warner Entertainment Company, L.P., by its attorneys, hereby submits its comments in response to the Commission's Notice of Proposed Rulemaking in the above-captioned proceeding.

INTRODUCTION

The incumbent local exchange telephone carriers prospered under a regulatory regime that gave them a legal monopoly on a vital public service and gave them the opportunity to recover from their captive subscribers the investments necessary to provide that service. Decades of legally protected monopoly status enabled the incumbent local exchange carriers to construct formidable business enterprises and corporate infrastructures, in addition to their plant and facilities, all at ratepayer expense.

Telephone companies have long been engaged to a limited extent in offering unregulated services in competitive or potentially competitive markets in addition to their monopoly services. Regulators have recognized the need to make sure that the telephone companies did not cause users of monopoly telephone service to bear the costs of such unregulated ventures. While the primary focus of regulators' attention was and is the protection of ratepayer interests, those ratepayer interests are entirely congruent with the interests of competitive entrants, such as TWC, that face the threat of economically inefficient, cross-subsidized competition from the telephone companies.

The Telecommunications Act of 1996[1] is intended to accelerate dramatically the expansion by the local telephone companies into businesses outside their traditional monopoly services, including especially providing services in which the telephone companies will be competing with firms that do not have recourse to legally protected revenue streams from captive customers. Although the 1996 Act also encourages competitive entry into the telephone companies' traditional markets, the telephone companies' expansion into providing new services is already occurring on a substantial scale, whereas competitive entry into the telephone companies' traditional services is still in its incipiency. Thus, in order for competition to develop to

1 Telecommunications Act of 1996, Pub. L. No. 104-104, 101 Stat. 56 (1996).

any notable extent, it will continue for some significant period of time to be essential to ensure that the telephone companies do not make local telephone service ratepayers bear the costs of the telephone companies' new competitive business activities. This proceeding concerns the rules necessary to accomplish that important objective.

Because telephone service ratepayers have financed the corporate and technological platform from which the telephone companies are setting out to launch their new, nonregulated business activities, it is appropriate that ratepayers not only be protected against cross subsidies in favor of nonregulated business ventures but that ratepayers also share in the benefits created by such ventures. Such sharing can be achieved, in part, by ensuring that ratepayers benefit from savings made possible by scope economies arising from joint use of telephone company resources by regulated and nonregulated activities.

TWC supports the Commission's proposals to adopt and enforce clear and simple rules for allocation of common costs between regulated and nonregulated activities of telephone companies. Clear and simple rules will simplify compliance and enforcement and reduce opportunities for evasion.

In TWC's view, the Commission has identified appropriate goals and objectives and has advanced constructive and administratively manageable approaches to the questions presented. In particular, TWC encourages the Commission to adhere to its tentative decision to promulgate a fixed, non-usage-based percentage allocator for common costs and to apply that allocator to all common costs not directly assigned. TWC believes that investment patterns and important policy concerns combine to support a fixed allocation of no more than 25 percent of common costs to traditional telephone service, with the remainder allocated to the new, competitive services (primarily broadband video and data services) for which the telephone companies are aggressively incurring new costs.

DISCUSSION

I. CLEAR AND SIMPLE COST ALLOCATION RULES ARE NECESSARY TO PREVENT INCUMBENT LOCAL EXCHANGE CARRIERS FROM IMPOSING ON REGULATED TELEPHONE SERVICE RATEPAYERS THE COSTS AND RISKS OF COMPETITIVE, NONREGULATED VENTURES.

The concern over cross-subsidization of video and other non-voice-telephone services by captive telephone service ratepayers is one to which much attention has been directed over the past several years. It was, for example, a major focal point of the debate over the Commission's authorization of "video dial tone" systems.[2] The basic concern has pervaded almost two decades of controversy over telephone company participation in competitive

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2 *Reporting Requirements on Video Dialtone Costs and Jurisdictional Separations for Local Exchange Carriers Offering Video Dialtone Services,* 10 FCC Rcd. 11292, 11295 (1995); *Telephone Company-Cable Television Cross-Ownership Rules,* 10 FCC Rcd. 244, 326 (1994).

businesses.[3] In dealing with these matters, it is generally recognized that allocation of common costs not susceptible to direct assignment is inherently arbitrary in an economic -- not a legal -- sense.[4]

Against this background, the Commission has correctly focused this proceeding on the central public policy objective to be served by an allocation methodology: Making sure that regulated telephone service ratepayers do not bear the costs of the telephone companies' nonregulated business ventures. TWC wholeheartedly agrees with the Commission's identification of the basic principles that are to guide this proceeding -- administrative simplicity, adaptability to evolving technologies, uniform application among incumbent local exchange carriers, and consistency with economic principles of cost causation.

II. THE STATUTORY AND POLICY GOALS IDENTIFIED BY THE COMMISSION WILL BEST BE ACHIEVED BY REQUIRING INCUMBENT LOCAL EXCHANGE CARRIERS TO ALLOCATE COMMON COSTS IN PRESCRIBED COST POOLS BASED ON FIXED FACTORS.

The proposals in the Notice seem to originate in a well-founded concern that traditional usage-based Part 64 allocation

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3 *See, e.g., Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities,* 2 FCC Rcd. 1298, *recon.* 2 FCC Rcd. 6283 (1987), *further recon.,* 3 FCC Rcd. 6701 (1988), *aff'd sub nom. Southwestern Bell Corp. v. FCC,* 896 F.2d 1378 (D.C. Cir. 1990).

4 *See, e.g.,* James C. Bonbright, *et al., Principles of Public Utility Rates* 31, 118-19 (2d ed. 1988).

methods may produce distorted results when applied in circumstances in which the regulated and nonregulated services have significantly different characteristics and tend to use facilities in different ways and in different proportions. TWC agrees with the Commission's tentative conclusion (Notice at ¶ 33) that usage-based allocation would produce unsatisfactory results, generally for the reasons identified by the Commission. Traditional notions of usage, based on circuit counts and time measurements, are relevant only where the regulated and nonregulated services have similar technical characteristics and requirements. The contrast between traditional voice telephony and multichannel video services illustrates the general point that regulated and nonregulated services likely to be sharing common facilities of incumbent local exchange carriers will place very different demands on those common facilities, some of which will be directly identifiable and assignable but others of which will have to be allocated on the basis of policy decisions precisely because there is no reasonable way to compare or equate the disparate services' usage of common facilities.

TWC is also of the view that an allocation method based on a ratio of directly assigned plant, as described in paragraph 34 of the Notice, would produce unsatisfactory results, substantially for the reason identified by the Commission. In the likely event that common costs of loops and interoffice trunks come to predominate over directly assigned stand-alone costs of such facilities, one would end up with relatively minor (and easily manipulated) cost elements dictating the allocation of the major cost elements; in other words, the directly-assigned tail would end up wagging the common cost dog. Opportunities for improper manipulation of such a method would be numerous and would likely undermine the Commission's stated objectives for an allocation methodology.

The cost-ceiling approach, under which all costs in excess of those of the current stand-alone telephone system would be allocated to nonregulated activities, has a definite theoretical appeal but would likely turn out, in practice, to be administratively complex, particularly if applied on an exchange-by-exchange basis. It also would have the potential to be inadequately responsive to technological change and uniform application could be frustrated by differing rates of technological evolution between carriers and locations. At the outset, such a method might be very consistent with economic principles of cost-causation, but it is uncertain whether that would remain true over time in a technologically dynamic industry.

For these reasons, TWC agrees with the Commission's tentative conclusion that a fixed factor approach would best achieve the Commission's goals. Fixed allocation factors, based on the wide variety of public policy considerations that the Commission may appropriately consider in setting such factors, would be administratively simple, adaptable to (and neutral toward) evolving technologies, readily susceptible to uniform application among telephone companies, and consistent, from a policy perspective, with the Commission's commitment to cost-causative cost assignment.

TWC agrees with the Commission's tentative conclusion that relative demand for regulated and nonregulated services cannot be the basis for an allocation factor, since -- as the Commission observes -- demand for traditional telephone service is highly inelastic and largely capable of being satisfied only by the incumbent local exchange carriers. A demand-based factor would cause captive telephone service ratepayers to bear a disproportionate share of common costs, a result exactly opposite from the Commission's stated objectives. Therefore, the Commission's choice of an allocation factor must be based on reasonable policy judgments.

III. REASONABLE PUBLIC POLICY CONSIDERATIONS CAN AND SHOULD FORM THE BASIS FOR THE COMMISSION'S DETERMINATION OF FIXED ALLOCATION FACTORS.

A. Allocation of Common Costs Based on Reasonable Public Policy Considerations Is Legally Permissible.

Direct assignment of costs to services on a cost-causative basis is, of course, the preferred approach to cost recovery in rate regulation.[5] Common costs are, by definition, costs that are not directly assignable to a particular service.

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5 *See, e.g.,* 47 C.F.R. § 64.901(b)(2) and (b)(3)(i).

In the words of the D.C. Circuit, "[t]he very problem at issue here -- allocation of common costs -- arises precisely because there is no purely economic method of allocation."[6] For that reason, regulators must decide how to allocate costs on the basis of "fairness and other noneconomic values".[7]

The Commission has identified public policy objectives -- avoidance of cross-subsidies and assurance that ratepayers share fairly in the benefits of scope economies -- that fully justify adoption of an allocation methodology that requires nonregulated competitive services to bear substantially more of the common costs than traditional regulated services.[8]

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6 *MCI Telecommunications Corp. v. FCC,* 675 F.2d 408, 415-16 (D.C. Cir. 1982).

7 *Id.* at 416.

8 The public policy issues inherent in regulated telephone company expansion into unregulated services such as video are, of course, very different from those that arise where a firm that has not been subject to public utility regulation (such as a cable television operator) enters the telephone companies' traditional monopoly businesses.

B. Public Policy Considerations And Available Data Indicate that No More than 25 Percent of Common Costs Should be Allocated to Regulated Services; The Remaining 75 Percent (Or More) Should be Allocated to Nonregulated Services.

The Notice recognizes (at ¶ 23) that it is necessary and appropriate intentionally to allocate "a significant part" of common costs to the telephone companies' nonregulated services. Such allocation both diminishes the likelihood of cross-subsidies and gives telephone service ratepayers some benefit for their contribution to the telephone companies' ability to realize economies of scope and scale.

Allocation of the greater proportion of common costs to nonregulated services also makes sense because those are the services for which most new investment is likely to be undertaken and in which there is the greatest likelihood for growth in scope and revenue. The overarching statutory goal of protecting the interests of subscribers to the telephone companies' regulated services can best be advanced if such subscribers are net beneficiaries of the telephone companies' new, nonregulated business ventures.

Those fundamental policy considerations can best be served by an allocation that apportions a significant majority of the relevant common costs to the nonregulated services. Balancing of the various considerations at issue, and recognizing that regulated services must bear some share of common costs, TWC believes that a fixed allocation of no more than 25 percent of common costs of loops, switches, interoffice trunks, and expenses to regulated services would produce the result most in harmony with the Commission's -- and Congress's -- policy goals. The same 25 percent allocation factor should apply to all common costs addressed in the Notice: loops, interoffice trunks, switching plant, network related expenses, marketing expenses, and overheads.

IV. COSTS ASSOCIATED WITH SPARE FACILITIES AND OTHER FORMS OF EXCESS CAPACITY SHOULD BE ALLOCATED TO THE NONREGULATED SERVICES THAT PREDOMINANTLY GIVE RISE TO THE CONSTRUCTION OF SUCH FACILITIES TODAY.

As the Commission observed in the Notice, spare (or excess) capacity as a proportion of total capacity is growing, and much of it is likely to be used for nonregulated video and broadband services. Telephone companies today are making major investments in hybrid fiber/coaxial cable plant for loops and interoffice trunks. Such plant, especially in loop applications, is necessary only for the provision of broadband services such as video; existing copper wire pairs (or digital loop carrier facilities) are entirely satisfactory for the provision of traditional voice-grade telephone service. The capacity of the broadband facilities now being (and planned to be) built by telephone companies greatly exceeds current demand for any service (voice or video), leading to substantial excess capacity.

TWC shares the Commission's belief that "Congress did not intend that telephone exchange service or exchange access subscribers pay rates designed to recover the costs of spare capacity that eventually will be used for video programming and other services that may be competitive." Notice at ¶ 53 (footnote omitted). Captive telephone service ratepayers should not bear the costs of building facilities that are not necessary to the provision of traditional telephone service. To allow such excess capacity to be built at regulated ratepayers' expense creates an uneconomic and undesirable incentive for construction of plant that is not needed and would not be built by a firm subject to normal competitive constraints.

TWC also welcomes the Commission's recognition that the excess capacity question encompasses also the issues arising from telephone company construction of broadband plant in anticipation of needing it in the future to provide new competitive services in competition with firms that may try to compete with telephone companies. Costs associated with investments in facilities not currently necessary to provide traditional telephone service should not be borne by telephone service ratepayers. For example, broadband facilities at the local loop level are totally unnecessary to the provision of regulated telephone service. Such facilities are constructed solely to enable the telephone companies to provide competitive, nonregulated services.

In some cases, such as that of GTE in the Tampa/St. Petersburg, Florida area, the telephone company's apparent position is that new hybrid fiber/coaxial cable plant is being constructed entirely to accommodate new video services. In that event, the entire amount of the investment, and all associated costs, should be directly assigned to the nonregulated category. This includes the utilization of any "telephone company" facilities, equipment, personnel, and resources in the building and maintenance of video plant and the marketing of video services. In other cases, such as the facilities being constructed by Pacific Bell in San Diego, California, there is an expressed intention to use the facilities for a variety of regulated and nonregulated services, including among them video services and traditional voice telephone service.[9] In that event as well, principles of cost causation should lead to assignment of all of the costs of such plant to the nonregulated category, since the plant would not have been constructed if the telephone company were offering only voice telephone service.

In response to the Commission's inquiry in paragraph 53 of the Notice, common costs associated with spare facilities that cannot be directly assigned to competitive services should be placed in a separate cost pool or pools for ease and transparency in allocation.

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9 *See* Pacific Bell's 20 December 1993 "Application for authority pursuant to Section 214 of the Communications Act of 1934, and Section 63.01 of the Commission's Rules and Regulations to construct and maintain advanced telecommunications facilities to provide video dialtone services to selected communities in San Diego, California area" at 2, 5.

V. OPEN VIDEO SYSTEM CERTIFICATIONS SHOULD NOT BE ACCEPTED UNTIL COST ALLOCATION RULES ARE IN PLACE, AND OVS APPLICANTS SHOULD BE REQUIRED TO CERTIFY COMPLIANCE WITH THE COST ALLOCATION RULES.

The Commission acknowledges, at the outset of the Notice (Notice at ¶¶ 7-8), the relationship of the issues in this proceeding to those being addressed in the *Open Video Systems* rulemaking, CS Docket No. 96-46. Open video systems present many of the issues that were present in the video dialtone proceedings, especially the crucial question of allocation of common costs between the largely unregulated and presumptively competitive OVS activity and the regulated telephone services. TWC contended in the OVS proceeding,[10] and reiterates here, that cost allocation principles and rules must be in place before any OVS certification is accepted for filing. No OVS investment can be reasonably planned or approved unless the incumbent local exchange carrier and the Commission know what costs will have to be recovered in connection with that investment. The statutory ten-day review period for OVS applications[11] is much too short for cost allocation issues to be addressed and resolved after the certification is filed. Certification as to compliance with the cost allocation rules must be a basic requirement of an OVS certification, and the cost allocation rules therefore have to be in place before the certification process commences.

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10 *See Comments of Time Warner Cable*, CS Docket No. 96-46, at 15-16 (filed 1 April 1996).

11 47 U.S.C. § 573(a)(1).

VI. POLE ATTACHMENT COSTS ASSOCIATED WITH COMMON PLANT SHOULD BE IMPUTED TO REGULATED AND NONREGULATED COSTS, SO AS TO GIVE LOCAL TELEPHONE SERVICE RATEPAYERS THE BENEFIT OF THEIR INVESTMENT IN POLES AND CONDUITS.

The requirement in Section 224(g) of the 1996 Act that pole attachment charges be imputed to telephone company services reflects a congressional determination that regulated service ratepayers obtain the benefit of their investment in poles and conduits through the reduction in the regulated revenue requirement that will result from such imputation. To the best of TWC's ability to determine, this statutory objective could be achieved through any of the three means suggested by the Commission in paragraph 56 of the Notice.

CONCLUSION

Overall, TWC supports the Commission's proposals and tentative conclusions with respect to cost allocation. TWC respectfully urges the Commission to adopt a fixed allocator that allocates no more than 25 percent of common costs to regulated services. The allocation requirement should be finalized before the Commission permits OVS certifications to be filed, and OVS applicants should be required affirmatively to certify compliance with the allocation rules.

Respectfully submitted,

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